



May 19, 1997

The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Dingell:

Thank you for allowing us to provide the views of Baltimore Gas And Electric Company and Potomac Electric Power Company concerning possible legislation affecting the future of the electric power industry. In light of the pending merger of our two companies, we concluded that a joint response to your inquiry was appropriate.

There are many complex issues to be addressed in an appropriate manner in order to ensure that the country's electric industry can continue to provide the high level of reliable service that its customers expect. Enclosed are the responses to the specific questions that you have raised.

If you need any further information, please do not hesitate to contact us.

Sincerely,

Edward F. Mitchell
Chairman of the Board and
Chief Executive Officer
Potomac Electric Power
Company

Christian H. Poindexter
Chairman of the Board and
Chief Executive Officer
Baltimore Gas And Electric
Company

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1. FROM YOUR COMPANY'S POINT OF VIEW, IS IT NECESSARY FOR CONGRESS TO ENACT LEGISLATION BEARING ON RETAIL COMPETITION, AND WHY? IF YOU FAVOR LEGISLATION, PLEASE OUTLINE WHICH ISSUES SHOULD BE ADDRESSED AND HOW YOU THINK THEY SHOULD BE RESOLVED.

The jurisdictions that regulate the Companies' retail service areas (Maryland and the District of Columbia) currently have restructuring investigations underway. The Companies believe that these regulators have the detailed knowledge of local conditions and regulatory history for the Companies and that this makes them the most appropriate bodies to determine what future industry structure for retail markets is in the public interest.

Federal legislation is unnecessary at this time except to repeal current provisions of Federal law that impede competition. Specifically, both the Public Utility Company Holding Act (PUCHA) and the Public Utility Regulatory Policy Act (PURPA) need to be repealed. The difficulty with Federal legislation is that once enacted, it is extremely difficult to amend or repeal even though a law, such as PURPA, is doing more harm than good. It is, of course, possible that as industry changes develop as a result of actions in the states, other issues requiring a federal legislative solution may emerge.

If there were to be federal legislation regarding industry restructuring, the following issues should be included. First, adequate provisions should be included which will ensure that the current high levels of reliability are maintained in a new industry structure. Second, federal legislation should mandate that all stranded costs (defined in response to Question 3B) that have been determined to have been prudently incurred and are authorized to be collected in the current regulatory environment be recovered through a non-bypassable stranded cost charge. The timing of the transition to a new regulatory structure should be left to the local regulatory agencies.

2. IF THE STATE(S) YOU SERVE HAS ADOPTED OR IS CONSIDERING ADOPTING RETAIL COMPETITION, WHAT ARE YOUR BIGGEST CONCERNS? PLEASE BE SPECIFIC. INDICATE HOW YOU ARE DEALING WITH THEM AND ANY RECOMMENDATIONS YOU MAY HAVE.

Both of the jurisdictions that regulate the Companies' retail service areas (Maryland and the District of Columbia) are currently investigating the future structure of the industry. The Companies' major concerns are:

- a) Reliability - provisions should be included which will ensure that the current high levels of reliability of the electric system are maintained.
- b) Level Playing Field - the Companies are concerned that they be allowed to compete for customers on the same basis as their competitors. This will require them to have the same flexibility to set prices for their generation, share obligations among all competitors for the costs of social programs/universal service, and equal treatment under the tax laws.
- c) Stranded/Transition Cost Recovery - costs that were incurred to fulfill the Companies' obligations to serve or pursuant to government mandate should be able to be recovered by the Companies. The stranded/transition cost recovery mechanism for this should be competitively neutral (such as a non-bypassable wires access charge).
- d) Tax Responsibility - the tax system will require adjustment so that all competitors are subject to the same level of taxation. For instance, the Companies are currently subject to a gross receipts tax on utility service and this tax will need to be assessed on all competitors or the required tax revenue will need to be collected in another manner that is competitively neutral.
- e) Market Control - state regulators should not attempt to impose regulation on the competitive aspects of an open retail market and should not attempt to dictate the evolving structure of the market or the structure of the companies competing to serve those markets.
- f) Obligation to Serve - the introduction of retail competition would require that the Companies' obligation to serve be redefined, if not eliminated. It would be fundamentally unfair, and wrong as a matter of economic principle, to maintain a utility obligation to provide generating resources for the benefit of customers who are free to acquire those resources from others.
- g) Lack of Reciprocity - If retail competition were implemented in the Companies' service territories, but not in the surrounding area, the consequences to the Companies, their customers, and the community could be severe. Suppliers from outside would be able to profiteer by picking the most attractive retail customers here, but the Companies would not have the opportunity to offset this potential loss of load by obtaining customers served by other electric utilities in other jurisdictions.

3. WHETHER OR NOT YOU FAVOR FEDERAL LEGISLATION, PLEASE INDICATE YOUR POSITION ON THE FOLLOWING SPECIFIC ISSUES (TO THE EXTENT NOT ADDRESSED IN YOUR PRIOR RESPONSES):

- A. *A FEDERAL MANDATE REQUIRING STATES TO ADOPT RETAIL COMPETITION BY A DATE CERTAIN.* IF RETAIL COMPETITION IS UNDER CONSIDERATION IN THE STATE(S) YOU SERVE, DO YOU BELIEVE CONGRESS SHOULD PROVIDE ADDITIONAL DIRECTION OR AUTHORITY?

No additional federal direction or authority by a date certain is necessary for the local jurisdictions that currently regulate the Companies.

- B. *RECOVERY OF STRANDED INVESTMENT.* IF THE STATE(S) YOU SERVE ALREADY HAS ADOPTED RETAIL COMPETITION, HOW WAS THIS ISSUE ADDRESSED AND ARE YOU SATISFIED WITH THE OUTCOME? IF YOUR STATE(S) IS CONSIDERING ADOPTING RETAIL COMPETITION, HOW WOULD YOU RECOMMEND THAT THIS ISSUE BE TREATED? DO YOU THINK CONGRESS SHOULD ENACT LEGISLATION RELATING TO STRANDED COST ISSUES, AND IF SO WHAT WOULD YOU RECOMMEND? IS SECURITIZATION A USEFUL MECHANISM FOR DEALING WITH STRANDED COSTS, AND WHOM DOES IT BENEFIT?

The two retail jurisdictions that the Companies serve have not adopted retail competition at this time, although both jurisdictions are currently investigating the future structure of the industry. The Companies are advocating that the local jurisdictions adopt legislation that will ensure the recovery of stranded/transition costs. The Companies believe that the recovery of stranded/transition costs in a manner suitable to the individual circumstances in each local jurisdiction is essential to ensure that retail competition does not produce economic distortions or impair the viability of the electric system. Prudently incurred stranded/transition costs are those that utilities are currently authorized to recover in their retail rates, including:

- Recovery of regulatory assets and other deferred charges recoverable under current regulatory practices.
- The unfunded portion of the utility's projected nuclear generating plant decommissioning costs.

- Cost obligations under contracts with non-utility generating projects that have been approved by regulators (including cancellation, buyout, buydown, or renegotiation costs approved by regulators).
- Costs of non-economic generation including the costs of generation used to meet reserve requirements.

If the local jurisdictions were not to adopt such legislation, the Companies would support federal legislation. If there is federal legislation on stranded costs, the legislation should direct the states to require full recovery of all prudently incurred stranded costs and enable the costs to be recovered as a non-bypassable wires charge on the use of the transmission system.

Securitization can be a useful tool in lowering interest expense that would benefit customers.

- C. *RECIPROCITY.* CAN STATES CONDITION ACCESS TO THEIR RETAIL MARKETS ON THE ADOPTION OF RETAIL COMPETITION BY OTHER STATES? SHOULD CONGRESS ENACT SUCH A REQUIREMENT? COULD SUCH A REQUIREMENT CREATE AN INCENTIVE FOR STATES WITH LOW ELECTRIC RATES NOT TO ADOPT RETAIL COMPETITION, IN ORDER TO KEEP CHEAP POWER AT HOME?

The Commerce Clause of the United States Constitution may limit the ability of states to condition access to their retail markets on the adoption of retail competition by other states. Congressional legislation imposing reciprocity requirements would allow for a fair market to develop; however, such a market will develop under market forces in any event.

4. IF CONGRESS ENACTS COMPREHENSIVE RESTRUCTURING LEGISLATION, SHOULD IT MANDATE "UNBUNDLING" OF LOCAL DISTRIBUTION COMPANY SERVICES? WHAT EFFECTS WOULD THIS HAVE, AND WOULD THEY DIFFER FOR VARIOUS CUSTOMER CLASSES? WOULD THIS ENTAIL SUBSTANTIAL EXPENSE, AND WHO WOULD INCUR ANY SUCH COSTS?

If Congress mandates industry restructuring, it should not attempt to impose regulation on local distribution companies. It is best to let market forces shape the industry. Any decisions made now on unbundling distribution services will most likely prove to be impediments in the future. These markets

are inherently "local" and there is no "one size fits all." Therefore, local regulatory bodies are best situated to continue any appropriate regulation.

5. RECENTLY CHAIR MOLER OF THE FEDERAL ENERGY REGULATORY COMMISSION RECOMMENDED THAT, AS PART OF COMPREHENSIVE LEGISLATION, CONGRESS AUTHORIZE THE COMMISSION TO ENFORCE COMPLIANCE WITH NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL STANDARDS TO HELP MAINTAIN RELIABILITY OF SERVICE. DO YOU BELIEVE THIS IS NECESSARY, AND WHY OR WHY NOT?

No. The North American Electric Reliability Council (NERC) has historically set voluntary standards for maintaining reliability and these standards have provided the high level of reliability of electric service in the United States. NERC is currently developing mandatory standards for all market participants which will be designed to maintain the high levels of reliability as the market structure of the industry changes. NERC should be allowed to continue this effort and there is no need for further federal legislation in this area at this time.

6. WHAT CONCERNS DOES YOUR COMPANY HAVE WITH RESPECT TO THE ROLE OF PUBLIC POWER AND FEDERAL POWER MARKETING AGENCIES IN AN INCREASINGLY COMPETITIVE WHOLESALE ELECTRIC MARKET? IN MARKETS IN WHICH RETAIL COMPETITION HAS BEEN ADOPTED? ARE THERE CONCERNS YOU WOULD LIKE TO HAVE ADDRESSED IF CONGRESS ENACTS COMPREHENSIVE RESTRUCTURING LEGISLATION? SHOULD CONGRESS CONSIDER CHANGES TO FEDERAL LAW AS IT APPLIES TO REGULATION OF PUBLIC OR FEDERAL POWER'S TRANSMISSION OBLIGATIONS?

Although the Companies do not have significant interactions with public power and federal power marketing agencies, the Companies believe that in an increasingly competitive power market, all participants should have to face the market bound by the same rules.

7. IF CONGRESS ENACTS COMPREHENSIVE RESTRUCTURING LEGISLATION, SHOULD CHANGES BE MADE TO FEDERAL, STATE OR LOCAL TAX CODES, AND IF SO, WHY? PLEASE BE SPECIFIC.

Yes. Changes will be required to the tax laws so that all competitors are treated equally. The tax codes in state and local jurisdictions have been developed under the current industry structure, which has franchised monopoly

service territories. Thus any taxes on the utility are collected with customers having only limited means of avoiding paying the tax. Given this industry structure, the local utility in many situations is subject to higher taxes than other enterprises. If there is to be retail choice for generation services, it will be important for state and local tax laws to be amended so that all providers of generation services are subject to the same tax liabilities.

For instance, in one of our jurisdictions, a 10% gross receipts tax is assessed on utility services. If retail choice is imposed, this tax will have to be interpreted as applying to all suppliers of generation services, and not just to the Companies.

8. WHAT, IF ANY, CONCERNS DO YOU HAVE ABOUT THE RELIABILITY OF THE ELECTRIC SYSTEM? IF THE INDUSTRY MOVED TO RETAIL COMPETITION, WILL ADEQUATE RESERVES BE AVAILABLE? IS THE TRANSMISSION SYSTEM CAPABLE OF HANDLING FULL RETAIL COMPETITION?

The Companies have two significant concerns about the effect of retail competition on reliability. The first concern is that adequate reserves be maintained to ensure the reliability of the bulk power system. Adequate reserves have two components, one is the amount of physical capacity that is installed to meet load and the other is the maintenance of that capacity so that it is available to meet load. Both of these issues can be addressed by the adoption of mandatory reliability requirements by the North American Electric Reliability Council.

The transmission system was initially constructed to deliver the output of local generating stations to the load. As transmission systems were developed over time, utility systems were interconnected to provide for enhanced reliability. These interconnections also allowed for the flow of economy energy between regions. Enhancements to the transmission system, along with appropriate operational practices, should allow for the development of a robust retail market for electricity without unduly affecting reliability.